2007-05234/

THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE JUNE 2007

OVERVIEW

- In the first quarter of 2007 real gross domestic product (GDP) growth accelerated to 3.7% following gains of about 1.5% in each of the three previous quarters.
- Domestic demand growth remained solid in the first quarter. Real final domestic demand grew 3.2% compared to 3.7% in the previous quarter. Growth in consumer spending on goods and services was healthy and residential investment rebounded after three consecutive declines. Business inventory accumulation climbed $3.6 billion after almost no change in the fourth quarter.
- Real imports grew more than real exports, but improved terms of trade (the ratio of export to import prices) boosted nominal exports more than nominal imports. The larger nominal trade surplus increased the current account surplus (the amount receipts from non-residents exceed payments to them) by $7.5 billion to $26.0 billion, or to 1.7% of nominal GDP from 1.3% in the fourth quarter.
- Employment grew 3.9% in the first quarter, up from 2.4% growth in the fourth. In May 2007 the unemployment rate was 6.1% for the fourth consecutive month, a 32-year low.

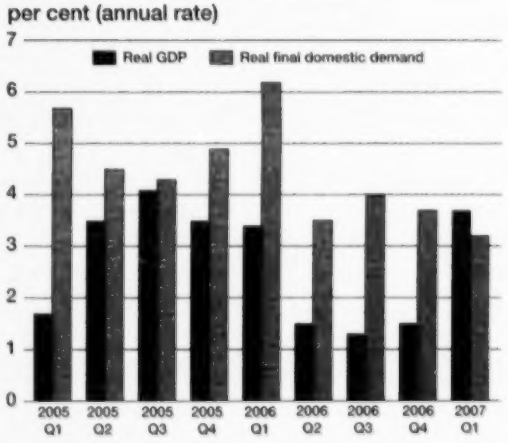
Real GDP increases 3.7%

Real GDP rose 3.7% in the first quarter of 2007 (Chart 1). Final domestic demand growth remained solid and inventory investment rebounded from a weak previous quarter. Real GDP outpaced final domestic demand for the first time in two and a half years.

Consumer spending stays healthy

Real consumer expenditure grew 3.9% in the first quarter of 2007, following an increase of 3.7% in the fourth quarter of 2006. Spending on durable goods (especially furniture and appliances), semi-durable goods (notably clothing and footwear) and non-durable goods grew faster than in the fourth quarter. However, growth of expenditures on services slowed.

Chart 1
Growth in real GDP and real final domestic demand



Note: Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is noon, June 12, 2007.

Main economic indicators
(per cent change at annual rates unless otherwise indicated)

	2005	2006	2006:Q3	2006:Q4	2007:Q1		Most recent
Real gross domestic product	3.1	2.8	1.3	1.5	3.7		–
Final domestic demand	4.5	4.7	4.0	3.7	3.2		–
Government expenditure							–
Goods and services	2.2	3.3	1.5	3.0	2.7		–
Gross fixed capital	10.9	8.1	0.4	4.1	-0.7		–
Consumer expenditure	3.8	4.2	5.1	3.7	3.9		–
Residential investment	3.5	2.1	-6.2	-0.1	7.5		–
Business fixed investment	10.8	9.9	9.7	6.8	-0.6		–
Non-residential construction	10.8	12.9	12.6	11.8	5.3		–
Machinery and equipment	10.8	7.4	7.1	2.3	-6.0		–
Business inventory investment ($ billion)	13.5	10.2	13.0	0.1	3.6		–
Exports	2.2	0.7	2.6	2.7	2.1		–
Imports	7.5	5.0	6.2	-0.9	2.6		–
Current account balance							
(nominal $ billion)	27.9	23.6	22.7	18.5	26.0		–
(percentage of GDP)	2.0	1.6	1.6	1.3	1.7		–
Nominal personal income	5.1	6.1	5.6	6.3	8.4		–
Nominal personal disposable income	4.3	6.4	5.8	5.6	8.5		–
Real personal disposable income	2.6	5.0	5.5	5.7	5.5		–
Profits before taxes	11.9	5.0	9.3	-0.8	13.0		–
Costs and prices (%, y/y)							
GDP price deflator	3.4	2.4	2.0	0.9	2.4		–
Consumer Price Index (CPI)	2.2	2.0	1.7	1.3	1.8	2.2	Apr-2007
Core CPI[1]	1.6	1.9	2.1	2.2	2.2	2.5	Apr-2007
Unit labour costs	2.6	3.1	2.8	3.6	3.2		
Wage settlements (total)	2.3	2.5	2.6	2.1	3.1	3.1	Mar-2007
Labour market							
Unemployment rate (%)	6.8	6.3	6.4	6.2	6.1	6.1	May-2007
Employment growth	1.4	1.9	0.6	2.4	3.9	0.7	May-2007
Financial markets (average)							
Exchange rate (U.S. cents)	82.6	88.2	89.2	87.8	85.4	94.29	11-Jun-07
Prime interest rate (%)	4.4	5.8	6.0	6.0	6.0	6.00	11-Jun-07

Note: Real values are in chained 1997 dollars.
[1] Core inflation excludes eight of the components of the CPI basket that display the greatest volatility, as well as the effect of changes in indirect taxes on the remaining components.
Sources: Statistics Canada, the Bank of Canada and Human Resources and Social Development Canada.

Personal income increased 8.4% in the first quarter. Labour income grew 8.2% after a 6.4% gain in the fourth quarter, given higher wages and salaries. Growth in labour income was boosted by a Quebec government pay equity settlement and a contribution from the Newfoundland and Labrador government to the Public Service Pension Plan. Real personal disposable income rose 5.5% and per capita real personal disposable income increased 4.9% to stand nearly 38% above its most recent trough in 1996. The personal savings rate was 2.6%, up from 2.2% in the previous quarter.

Residential investment grows but business investment weakens

Residential investment rose 7.5% in the first quarter after three consecutive declines. The home resale market strengthened to record levels, boosting ownership transfer costs 29.6%.

Spending on renovations increased 7.9%. New construction dipped 0.4%, the fourth successive quarterly decline.

Business investment in plant and equipment edged down 0.6% in the first quarter, with spending on machinery and equipment registering a 6.0% drop after 16 consecutive gains. Increased capital spending on furniture, computers, software and non-automotive transportation equipment was more than offset by reduced spending on motor vehicles and industrial, agricultural, telecommunications and other equipment.

Non-residential construction rose 5.3%, the 17th consecutive increase. Expenditures on building projects jumped 10.3%. Growth in spending on engineering projects slowed to 3.6% from 16.1% in the previous quarter.

Increased business inventory accumulation

Inventory investment rebounded from a weak fourth quarter. Businesses added $3.6 billion to inventories in the first quarter, up from the previous quarter's $0.1-billion increase but below the $13.0-billion accumulation in the third quarter of 2006. In the first quarter, wholesalers added non-durable goods while manufacturers raised their holdings of durable goods. However, the inventory-to-sales ratio fell due to strong sales in the quarter.

Real exports rise again

Real exports increased 2.1% in the first quarter, a third consecutive quarterly gain. Exports of machinery and equipment and automotive and energy products climbed. The overall gain, however, was partly offset by reduced exports of forest and industrial products as the U.S. housing market remained weak. Exports of services increased 3.6%.

Real imports increase

Real imports grew 2.6% in the first quarter following a 0.9% decrease in the previous quarter. Imports of energy, industrial and automotive products climbed and non-automotive consumer goods imports increased with consumer demand. However, imports of machinery and equipment declined 7.9% as growth in business investment weakened. This was the first decline in imports of machinery and equipment in the last 16 quarters. Imports of services were largely unchanged.

Current account surplus grows

In the first quarter, Canada's current account surplus increased $7.5 billion from its fourth-quarter level to $26.0 billion, rising to 1.7% of nominal GDP from 1.3% (Chart 2). A jump in the terms of trade (the ratio of export to import prices) produced a $9.5-billion improvement in the nominal trade surplus to $41.7 billion. That gain was only partly offset by a $2.7-billion worsening in the investment income deficit. Lower profits earned by Canadians on direct investments abroad reduced dividends received.

Corporate profits show a healthy gain

Corporate profits rose 13.0% in the first quarter following a dip of 0.8% in the fourth quarter. This raised their share of nominal GDP to 13.9% (Chart 3). While below the historical high set at the end of 2005, this is well above the historical average of 10.3%. The profits of the petroleum and coal products manufacturing sector jumped, due partly to rising commodity prices. Profits of retailers benefited from higher consumer spending.

Chart 2
Current account as a percentage of nominal GDP

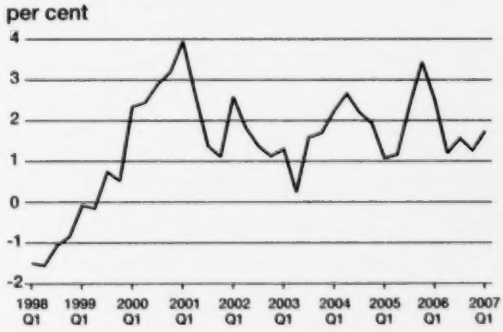


Chart 3
Profits before taxes as a share of nominal GDP

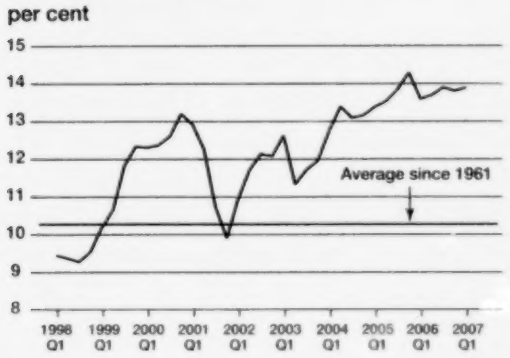
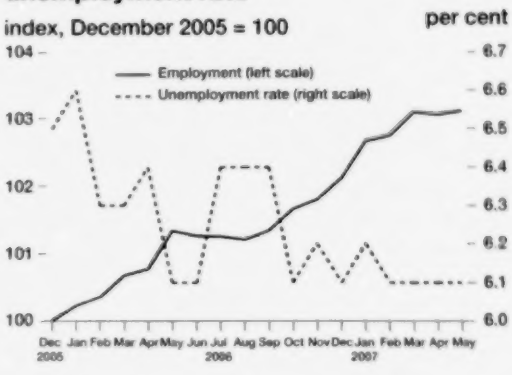


Chart 4
Employment and the unemployment rate



Consumer price inflation remains subdued but sits above the inflation target

The GDP deflator, a comprehensive measure of prices, climbed 6.1% in the first quarter, up from 0.4% in the fourth. This spike reflected the strength of commodity prices and the special labour income payments made by the Quebec and Newfoundland and Labrador governments. The GDP deflator stood 2.4% higher than a year earlier.

Year-over-year consumer price inflation decreased to 2.2% in April 2007 from 2.3% in March, due mainly to a slowing in the rate of increase of gasoline prices. At 2.5% in April, core CPI inflation, which excludes the eight most volatile items and the effect of changes in indirect taxes, remained above the 2% inflation target.

Unemployment rate remains low

Employment grew 3.9% in the first quarter, up from 2.4% growth in the fourth. Despite only modest job growth in April and May 2007, net job creation in Canada stood at a healthy 508,600 since the end of 2005 (Chart 4). In May the unemployment rate remained at 6.1% for the fourth consecutive month, the lowest level in 32 years. The participation rate stood at 67.5%, down slightly from April and just below the record high of 67.7% last seen in March.

Hourly labour productivity for the total economy grew 1.8% in the first quarter, more than double the pace of the previous quarter. Labour costs per unit of output on a total economy basis rose in the first quarter to stand 3.2% higher than a year earlier.

Bank of Canada holds policy rate steady

On May 29, the Bank of Canada held its key policy rate—the target for the overnight rate—unchanged at 4.25% for the eighth consecutive announcement, after seven one-quarter-percentage-point increases over nine months through to May 2006. The Bank stated that "there is an increased risk that future inflation will persist above the 2 per cent inflation target and that some increase in the target for the overnight rate may be required in the near term to bring inflation back to the target." On May 9, the U.S. Federal Reserve maintained a policy rate of 5.25% for the seventh consecutive Federal Open Market Committee decision. That followed 17 increases during a period of monetary tightening that the Federal Reserve initiated in June 2004. U.S. rates at all maturities exceed those in Canada.

The Canadian dollar closed at 94.29 U.S. cents on June 11.

The main source of data used in this publication is Statistics Canada. Subscription inquiries should be directed to the Department of Finance Distribution Centre at 613-995-2855. For other inquiries about this publication, contact Isabelle Amano at 613-992-4364.
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